

AMENDED IN SENATE MAY 19, 2014

AMENDED IN SENATE MAY 6, 2014

AMENDED IN SENATE APRIL 22, 2014

AMENDED IN SENATE APRIL 9, 2014

## SENATE BILL

**No. 998**

**Introduced by Senator Knight**

**(Coauthor: Senator Fuller)**

*(Coauthor: Assembly Member Gorell)*

February 13, 2014

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An act to amend Section 6377.1 of, ~~and to add Sections 17053.35 and 23635 to,~~ the Revenue and Taxation Code, relating to taxation, to take effect immediately, tax levy.

### LEGISLATIVE COUNSEL'S DIGEST

SB 998, as amended, Knight. Taxes: exemption and credits: new aerospace projects.

~~The Personal Income Tax Law and the Corporation Tax Law allow various credits against the taxes imposed by those laws.~~

~~This bill would, for taxable years beginning on or after January 1, 2015, allow a credit against those taxes to a qualified taxpayer equal to the amount of capital investment in a new aerospace project, as defined. This bill would require the Franchise Tax Board, and authorize the State Board of Equalization, to prescribe specified rules, guidelines, or procedures regarding the determination of generated tax revenues.~~

Existing sales and use tax laws impose taxes on retailers measured by the gross receipts from the sale of tangible personal property sold at retail in this state, or on the storage, use, or other consumption in this state of tangible personal property purchased from a retailer for storage,

use, or other consumption in this state, and provides various exemptions from those taxes.

Existing law exempts from those taxes, on and after July 1, 2014, and before January 1, 2022, the gross receipts from the sale of, and the storage, use, or other consumption of, qualified tangible personal property purchased by a qualified person for use primarily in manufacturing, processing, refining, fabricating, or recycling of property; qualified tangible personal property purchased for use by a contractor for specified purposes; and qualified tangible personal property purchased for use by a qualified person to be used primarily in research and development, as provided, and until January 1, 2021, the gross receipts from the sale of, and the storage, use, or other consumption of, qualified tangible personal property purchased by a qualified person for those purposes. This exemption does not apply to tangible personal property purchased during any calendar year that exceeds ~~two hundred million dollars~~ \$200,000,000 of purchases of qualified tangible personal property for which an exemption is claimed by a qualified person.

*This bill would ~~exempt the, from January 1, 2015, until January 1, 2018, impose a \$300,000,000 limit, rather than a \$200,000,000 limit, on exempt purchases of manufacturing and research and development equipment for use in a new aerospace project, as defined in this bill; from the two hundred million dollar annual limit on exempt purchases by a qualified person. The bill would, on January 1, 2017, require the Board of Equalization report to the Legislature on the amount of manufacturing and research and development equipment purchased for use in a new aerospace project since January 1, 2015. The bill would, on January 1, 2017, require the Employment Development Department to report to the Legislature on any increase in aerospace manufacturing employment since January 1, 2015.~~*

This bill would take effect immediately as a tax levy.

Vote: majority. Appropriation: no. Fiscal committee: yes.

State-mandated local program: no.

*The people of the State of California do enact as follows:*

- 1 SECTION 1. Section 6377.1 of the Revenue and Taxation
- 2 Code is amended to read:
- 3 6377.1. (a) Except as provided in subdivision (e), on or after
- 4 July 1, 2014, and before July 1, 2022, there are exempted from the

1 taxes imposed by this part the gross receipts from the sale of, and  
2 the storage, use, or other consumption in this state of, any of the  
3 following:

4 (1) Qualified tangible personal property purchased for use by  
5 a qualified person to be used primarily in any stage of the  
6 manufacturing, processing, refining, fabricating, or recycling of  
7 tangible personal property, beginning at the point any raw materials  
8 are received by the qualified person and introduced into the process  
9 and ending at the point at which the manufacturing, processing,  
10 refining, fabricating, or recycling has altered tangible personal  
11 property to its completed form, including packaging, if required.

12 (2) Qualified tangible personal property purchased for use by  
13 a qualified person to be used primarily in research and  
14 development.

15 (3) Qualified tangible personal property purchased for use by  
16 a qualified person to be used primarily to maintain, repair, measure,  
17 or test any qualified tangible personal property described in  
18 paragraph (1) or (2).

19 (4) Qualified tangible personal property purchased for use by  
20 a contractor purchasing that property for use in the performance  
21 of a construction contract for the qualified person, that will use  
22 that property as an integral part of the manufacturing, processing,  
23 refining, fabricating, or recycling process, or as a research or  
24 storage facility for use in connection with those processes.

25 (b) For purposes of this section:

26 (1) “Fabricating” means to make, build, create, produce, or  
27 assemble components or tangible personal property to work in a  
28 new or different manner.

29 (2) “Manufacturing” means the activity of converting or  
30 conditioning tangible personal property by changing the form,  
31 composition, quality, or character of the property for ultimate sale  
32 at retail or use in the manufacturing of a product to be ultimately  
33 sold at retail. Manufacturing includes any improvements to tangible  
34 personal property that result in a greater service life or greater  
35 functionality than that of the original property.

36 (3) “Primarily” means 50 percent or more of the time.

37 (4) “Process” means the period beginning at the point at which  
38 any raw materials are received by the qualified person and  
39 introduced into the manufacturing, processing, refining, fabricating,  
40 or recycling activity of the qualified person and ending at the point

1 at which the manufacturing, processing, refining, fabricating, or  
2 recycling activity of the qualified person has altered tangible  
3 personal property to its completed form, including packaging, if  
4 required. Raw materials shall be considered to have been  
5 introduced into the process when the raw materials are stored on  
6 the same premises where the qualified person's manufacturing,  
7 processing, refining, fabricating, or recycling activity is conducted.  
8 Raw materials that are stored on premises other than where the  
9 qualified person's manufacturing, processing, refining, fabricating,  
10 or recycling activity is conducted shall not be considered to have  
11 been introduced into the manufacturing, processing, refining,  
12 fabricating, or recycling process.

13 (5) "Processing" means the physical application of the materials  
14 and labor necessary to modify or change the characteristics of  
15 tangible personal property.

16 (6) (A) "Qualified person" means a person that is primarily  
17 engaged in those lines of business described in Codes 3111 to  
18 3399, inclusive, 541711, or 541712 of the North American Industry  
19 Classification System (NAICS) published by the United States  
20 Office of Management and Budget (OMB), 2012 edition.

21 (B) Notwithstanding subparagraph (A), "qualified person" shall  
22 not include either of the following:

23 (i) An apportioning trade or business that is required to apportion  
24 its business income pursuant to subdivision (b) of Section 25128.

25 (ii) A trade or business conducted wholly within this state that  
26 would be required to apportion its business income pursuant to  
27 subdivision (b) of Section 25128 if it were subject to apportionment  
28 pursuant to Section 25101.

29 (7) (A) "Qualified tangible personal property" includes, but is  
30 not limited to, all of the following:

31 (i) Machinery and equipment, including component parts and  
32 contrivances such as belts, shafts, moving parts, and operating  
33 structures.

34 (ii) Equipment or devices used or required to operate, control,  
35 regulate, or maintain the machinery, including, but not limited to,  
36 computers, data processing equipment, and computer software,  
37 together with all repair and replacement parts with a useful life of  
38 one or more years therefor, whether purchased separately or in  
39 conjunction with a complete machine and regardless of whether

1 the machine or component parts are assembled by the qualified  
2 person or another party.

3 (iii) Tangible personal property used in pollution control that  
4 meets standards established by this state or any local or regional  
5 governmental agency within this state.

6 (iv) Special purpose buildings and foundations used as an  
7 integral part of the manufacturing, processing, refining, fabricating,  
8 or recycling process, or that constitute a research or storage facility  
9 used during those processes. Buildings used solely for warehousing  
10 purposes after completion of those processes are not included.

11 (B) “Qualified tangible personal property” shall not include any  
12 of the following:

13 (i) Consumables with a useful life of less than one year.

14 (ii) Furniture, inventory, and equipment used in the extraction  
15 process, or equipment used to store finished products that have  
16 completed the manufacturing, processing, refining, fabricating, or  
17 recycling process.

18 (iii) Tangible personal property used primarily in administration,  
19 general management, or marketing.

20 (8) “Refining” means the process of converting a natural  
21 resource to an intermediate or finished product.

22 (9) “Research and development” means those activities that are  
23 described in Section 174 of the Internal Revenue Code or in any  
24 regulations thereunder.

25 (10) “Useful life” for tangible personal property that is treated  
26 as having a useful life of one or more years for state income or  
27 franchise tax purposes shall be deemed to have a useful life of one  
28 or more years for purposes of this section. “Useful life” for tangible  
29 personal property that is treated as having a useful life of less than  
30 one year for state income or franchise tax purposes shall be deemed  
31 to have a useful life of less than one year for purposes of this  
32 section.

33 (c) An exemption shall not be allowed under this section unless  
34 the purchaser furnishes the retailer with an exemption certificate,  
35 completed in accordance with any instructions or regulations as  
36 the board may prescribe, and the retailer retains the exemption  
37 certificate in its records and furnishes it to the board upon request.

38 (d) (1) Notwithstanding the Bradley-Burns Uniform Local  
39 Sales and Use Tax Law (Part 1.5 (commencing with Section 7200))  
40 and the Transactions and Use Tax Law (Part 1.6 (commencing

1 with Section 7251)), the exemption established by this section  
2 shall not apply with respect to any tax levied by a county, city, or  
3 district pursuant to, or in accordance with, either of those laws.

4 (2) Notwithstanding subdivision (a), the exemption established  
5 by this section shall not apply with respect to any tax levied  
6 pursuant to Section 6051.2, 6051.5, 6201.2, or 6201.5, pursuant  
7 to Section 35 of Article XIII of the California Constitution, or any  
8 tax levied pursuant to Section 6051 or 6201 that is deposited in  
9 the State Treasury to the credit of the Local Revenue Fund 2011  
10 pursuant to Section 6051.15 or 6201.15.

11 (e) (1) The exemption provided by this section shall not apply  
12 to either of the following:

13 (A) (i) Except as provided in clause (ii), any tangible personal  
14 property purchased during any calendar year that exceeds two  
15 hundred million dollars (\$200,000,000) of purchases of qualified  
16 tangible personal property for which an exemption is claimed by  
17 a qualified person under this section. For purposes of this  
18 subparagraph, in the case of a qualified person that is required to  
19 be included in a combined report under Section 25101 or authorized  
20 to be included in a combined report under Section 25101.15, the  
21 aggregate of all purchases of qualified personal property for which  
22 an exemption is claimed pursuant to this section by all persons  
23 that are required or authorized to be included in a combined report  
24 shall not exceed two hundred million dollars (\$200,000,000) in  
25 any calendar year.

26 (ii) ~~Manufacturing~~ *(I) From January 1, 2015, until January 1,*  
27 *2018, manufacturing and research and development equipment*  
28 *purchased for use in a new aerospace project as defined in Sections*  
29 *17053.35 and 23635 shall not be considered subject to a*  
30 *three-hundred-million-dollar (\$300,000,000) limit, rather than a*  
31 *two-hundred-million-dollar (\$200,000,000) limit, for purposes of*  
32 ~~the two-hundred-million-dollar (\$200,000,000) limit established~~  
33 ~~by clause (i).~~

34 *(II) For the purposes of this clause, “new aerospace project”*  
35 *means the manufacturing, design, or testing of aircraft, aircraft*  
36 *engine, guided missiles, space vehicles, propulsion units, or related*  
37 *parts or components by the qualified taxpayer, pursuant to a*  
38 *contractual agreement between the qualified taxpayer and a*  
39 *purchaser, that commences in this state on or after January 1,*

1 2015, and has not commenced outside of this state prior to that  
2 date.

3 (III) On January 1, 2017, the board shall report to the  
4 Legislature on the amount of manufacturing and research and  
5 development equipment purchased for use in a new aerospace  
6 project since January 1, 2015.

7 (IV) On January 1, 2017, the Employment Development  
8 Department shall report to the Legislature on any increase in  
9 aerospace manufacturing employment since January 1, 2015.

10 (V) The reports required in subclauses (III) and (IV) shall be  
11 made in accordance with Section 9795 of the Government Code.

12 (B) The sale or storage, use, or other consumption of property  
13 that, within one year from the date of purchase, is removed from  
14 California, converted from an exempt use under subdivision (a)  
15 to some other use not qualifying for exemption, or used in a manner  
16 not qualifying for exemption.

17 (2) If a purchaser certifies in writing to the seller that the tangible  
18 personal property purchased without payment of the tax will be  
19 used in a manner entitling the seller to regard the gross receipts  
20 from the sale as exempt from the sales tax, and the purchase  
21 exceeds the two-hundred-million-dollar (\$200,000,000) limitation  
22 described in subparagraph (A) of paragraph (1), or within one year  
23 from the date of purchase, the purchaser removes that property  
24 from California, converts that property for use in a manner not  
25 qualifying for the exemption, or uses that property in a manner  
26 not qualifying for the exemption, the purchaser shall be liable for  
27 payment of sales tax, with applicable interest, as if the purchaser  
28 were a retailer making a retail sale of the tangible personal property  
29 at the time the tangible personal property is so purchased, removed,  
30 converted, or used, and the cost of the tangible personal property  
31 to the purchaser shall be deemed the gross receipts from that retail  
32 sale.

33 (f) This section shall apply to leases of qualified tangible  
34 personal property classified as “continuing sales” and “continuing  
35 purchases” in accordance with Sections 6006.1 and 6010.1. The  
36 exemption established by this section shall apply to the rentals  
37 payable pursuant to the lease, provided the lessee is a qualified  
38 person and the tangible personal property is used in an activity  
39 described in subdivision (a).

(g) (1) Upon the effective date of this section, the Department of Finance shall estimate the total dollar amount of exemptions that will be taken for each calendar year, or any portion thereof, for which this section provides an exemption.

(2) No later than each March 1 next following a calendar year for which this section provides an exemption, the board shall provide to the Joint Legislative Budget Committee a report of the total dollar amount of exemptions taken under this section for the immediately preceding calendar year. The report shall compare the total dollar amount of exemptions taken under this section for that calendar year with the department's estimate for that same calendar year. If that total dollar amount taken is less than the estimate for that calendar year, the report shall identify options for increasing exemptions taken so as to meet estimated amounts.

(h) This section is repealed on January 1, 2023.

SEC. 2. ~~Section 17053.35 is added to the Revenue and Taxation Code, to read:~~

~~17053.35. (a) For taxable years beginning on or after January 1, 2015, there shall be allowed to a qualified taxpayer a credit against the "net tax," as defined in Section 17039, an amount equal to the amount of capital investment in a new aerospace project.~~

~~(b) For purposes of this section, all of the following shall apply:~~

~~(1) "Capital investment" means expenses incurred for site preparation for, and the construction, repair, renovation, improvement, equipping, or furnishing of, a building, structure, or facility or improvement to real property, including associated soft costs. Capital investment includes obtaining and installing furnishings and machinery, apparatus, or equipment for the operation of a business in a building, structure, or facility or improvement to real property, site-related utility and transportation infrastructure improvements, and plantings or other environmental components.~~

~~(2) "Manufacturing" means the activity of converting or conditioning property by changing the form, composition, quality, or character of the property for ultimate sale at retail or use in the manufacturing of a product to be ultimately sold at retail or to a government customer. Manufacturing includes any improvements to tangible personal property that result in a greater service life or greater functionality than that of the original property.~~



1     ~~(3) “New aerospace project” means the manufacturing, design,~~  
2 ~~or testing of aircraft, aircraft engine, guided missiles, space~~  
3 ~~vehicles, propulsion units, or related parts or components by the~~  
4 ~~qualified taxpayer, pursuant to a contractual agreement between~~  
5 ~~the qualified taxpayer and a purchaser, that commences in this~~  
6 ~~state on or after January 1, 2015, and has not commenced outside~~  
7 ~~of this state prior to that date.~~

8     ~~(4) “New construction” has the same meaning as that term is~~  
9 ~~defined in Section 70.~~

10    ~~(5) “Primarily” means more than 50 percent.~~

11    ~~(6) “Qualified taxpayer” means a person who is primarily~~  
12 ~~engaged in those lines of business described in Code 3364 of the~~  
13 ~~North American Industry Classification System (NAICS) published~~  
14 ~~by the United States Office of Management and Budget (OMB);~~  
15 ~~2012 edition.~~

16    ~~(e) No credit shall be allowed under this section after the~~  
17 ~~conclusion or completion of the contractual agreement that is the~~  
18 ~~subject of the new aerospace project.~~

19    ~~(d) In the case where the credit allowed by this section exceeds~~  
20 ~~the “net tax,” the excess may be carried over to reduce the “net~~  
21 ~~tax” in the following year, and succeeding nine years if necessary;~~  
22 ~~until the credit is exhausted.~~

23    ~~(e) (1) The Franchise Tax Board shall prescribe rules,~~  
24 ~~guidelines, or procedures to be used by the qualified taxpayer to~~  
25 ~~determine its estimated “net tax” amount described in clause (i)~~  
26 ~~of subparagraph (A) of paragraph (1) of subdivision (b), and may~~  
27 ~~prescribe other rules, guidelines, or procedures necessary or~~  
28 ~~appropriate to carry out the purposes of this section, except as~~  
29 ~~provided in paragraph (2).~~

30    ~~(2) The State Board of Equalization may prescribe rules,~~  
31 ~~guidelines, or procedure necessary or appropriate for the~~  
32 ~~determination of the amount of increased ad valorem property tax~~  
33 ~~described in clause (ii) of subparagraph (A) of paragraph (1) of~~  
34 ~~subdivision (b).~~

35    ~~SEC. 3. Section 23635 is added to the Revenue and Taxation~~  
36 ~~Code, to read:~~

37    ~~23635. (a) For taxable years beginning on or after January 1,~~  
38 ~~2015, there shall be allowed to a qualified taxpayer a credit against~~  
39 ~~the “tax,” as defined in Section 23036, an amount equal to the~~  
40 ~~amount of capital investment in a new aerospace project.~~

~~(b) For purposes of this section, all of the following shall apply:~~

~~(1) “Capital investment” means expenses incurred for site preparation for, and the construction, repair, renovation, improvement, equipping, or furnishing, of a building, structure, or facility or improvement to real property, including associated soft costs. Capital investment includes obtaining and installing furnishings and machinery, apparatus, or equipment for the operation of a business in a building, structure, or facility or improvement to real property, site-related utility and transportation infrastructure improvements, and plantings or other environmental components.~~

~~(2) “Manufacturing” means the activity of converting or conditioning property by changing the form, composition, quality, or character of the property for ultimate sale at retail or use in the manufacturing of a product to be ultimately sold at retail or to a government customer. Manufacturing includes any improvements to tangible personal property that result in a greater service life or greater functionality than that of the original property.~~

~~(3) “New aerospace project” means the manufacturing, design, or testing of aircraft, aircraft engine, guided missiles, space vehicles, propulsion units, or related parts or components by the qualified taxpayer, pursuant to a contractual agreement between the qualified taxpayer and a purchaser, that commences in this state on or after January 1, 2015, and has not commenced outside of this state prior to that date.~~

~~(4) “New construction” has the same meaning as that term is defined in Section 70.~~

~~(5) “Primarily” means more than 50 percent.~~

~~(6) “Qualified taxpayer” means a person who is primarily engaged in those lines of business described in Code 3364 of the North American Industry Classification System (NAICS) published by the United States Office of Management and Budget (OMB), 2012 edition.~~

~~(c) No credit shall be allowed under this section after the conclusion or completion of the contractual agreement that is the subject of the new aerospace project.~~

~~(d) In the case where the credit allowed by this section exceeds the “net tax,” the excess may be carried over to reduce the “net tax” in the following year, and succeeding nine years if necessary, until the credit is exhausted.~~

1     ~~(e) (1) The Franchise Tax Board shall prescribe rules,~~  
2     ~~guidelines, or procedures to be used by the qualified taxpayer to~~  
3     ~~determine its estimated “net tax” amount described in clause (i)~~  
4     ~~of subparagraph (A) of paragraph (1) of subdivision (b), and may~~  
5     ~~prescribe other rules, guidelines, or procedures necessary or~~  
6     ~~appropriate to carry out the purposes of this section, except as~~  
7     ~~provided in paragraph (2).~~

8     ~~(2) The State Board of Equalization may prescribe rules,~~  
9     ~~guidelines, or procedure necessary or appropriate for the~~  
10    ~~determination of the amount of increased ad valorem property tax~~  
11    ~~described in clause (ii) of subparagraph (A) of paragraph (1) of~~  
12    ~~subdivision (b).~~

13    ~~SEC. 4.~~

14    ~~SEC. 2.~~ This act provides for a tax levy within the meaning of  
15    Article IV of the Constitution and shall go into immediate effect.